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May 16, 1996

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MAY 16 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 (CC Docket No. 96-98)

Dear Mr. Caton:

Enclosed for filing are the original and sixteen copies (two of which have been annotated "Extra Public Copy") of the Comments of the Telecommunications Carriers for Competition. In addition, a diskette in WordPerfect 5.1 format has been submitted to Janice Myles, Common Carrier Bureau.

Please return a date-stamped copy of the enclosed (copy provided).

Respectfully submitted,

Linda L. Oliver

Linda L. Oliver
Counsel for Telecommunications
Carriers for Competition

Enclosures

cc: Janice Myles, Common Carrier Bureau
ITS

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MAY 16 1996
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Docket No. 96-98
	)	
	)	

COMMENTS OF THE TELECOMMUNICATIONS CARRIERS FOR COMPETITION

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Dated: May 16, 1996

TABLE OF CONTENTS

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EXECUTIVE SUMMARY

The Telecommunications Carriers for Competition ("TCC") is a coalition of some of the nation's leading service providers with a common vision of steps that must be taken to make competition in the local exchange a reality. Its members include AT&T; the Competitive Telecommunications Association ("CompTel"); General Communication, Inc.; LCI International Telecom Corporation; LDDS WorldCom; and MCI Telecommunications Corporation.

1. The 1996 Act transforms the telecommunications landscape by eliminating the 1984 divestiture decree. However, the factual premise underlying the MFJ is unchanged in 1996. The ubiquitous local exchange network remains a monopoly, and all service providers are dependent on access to that network to reach end users. Although some carriers, including some TCC members, have begun to construct limited local facilities in certain cities, the reality is that those facilities serve only a small percentage of customers today. Even in the long run, it is unlikely that many carriers -- if any -- will be in a position to duplicate the incumbent ILEC ("ILEC") network.

Sections 251 and 252 respond directly to these practical barriers to competition by permitting local competition to begin and grow using the ILEC network. The Act's interconnection, unbundling, and service resale provisions (including pricing requirements) recognize that ILECs cannot be allowed to discriminate in these areas against competing telecommunications carriers. Otherwise, competitors will not be able to add local service to their product lines, let alone do so as easily as the RBOCs will be able to add long distance.

2. The Act therefore requires the FCC to adopt strong, uniform national rules to govern ILEC duties to other carriers, including rules establishing the appropriate pricing methodology. Voluntary negotiations are highly unlikely to be successful in establishing the preconditions for competition. The parties come to

the table with unequal bargaining power. The competing carriers absolutely need access to the ILEC network; they cannot take their business elsewhere. The ILECs, on the other hand, require nothing from their competitors, and have strong incentives to deny their competitors the practical ability to employ the ILEC network to provide competing services. The TCC members' own experiences with negotiation, both before and after passage of the Act, confirm this problem.

Strong national rules are essential in order for the FCC and state commissions to fulfill their important roles in making the promise of the Act a reality. In addition, the FCC must be firm that no RBOC entry application can be granted until all the interconnection, unbundling, and resale requirements of the Act are fully implemented, including pricing that complies with the FCC's methodology. To satisfy Section 251 and thus Section 271(c)(2), moreover, unbundled elements and wholesale services must be provisioned via automated, nondiscriminatory operational support mechanisms that are fully in place, proven workable, and shown to provide the customers of requesting carriers the same quality of service, in every respect, that is available to the ILEC's own customers

3. Section 252 (d)(1) of the Act requires that interconnection and unbundled network elements be priced on the basis of the <u>economic cost</u> of the incumbent LEC network. That section requires that rates be set "based on cost" and "without regard to rate-of-return or other rate based-proceeding[s]."

Economic cost is the cost that the incumbent LEC itself faces in providing service. For competition to succeed, the ILEC's competitors similarly must pay economic cost for us of the same ILEC network to provide service. Neither the statutory standard nor economic theory support inclusion of historical or embedded costs in rates for interconnection and unbundled network elements. The proper measure of economic cost is total service long run incremental cost or TSLRIC, a standard that is commonly used in state rate-setting proceedings.

TSLRIC studies already have been done by many ILECs: this data can be obtained and used to establish actual rates within a reasonable time frame.

4. The FCC must establish the basic principles for network unbundling. The FCC should: require ILECs to respond to all unbundling requests; place the burden on ILECs to demonstrate technical infeasibility (with availability of an element from another ILEC constituting prima facie evidence of feasibility); prohibit restrictions on the ability of requesting carriers to use the elements for any purpose; require in particular provision of an unbundled switching element; require ILECs to provide unbundled elements in a manner that allows competitors to combine them in a platform configuration; define the unbundling obligation as evolutionary (with the FCC and state commissions permitted to expand the list over time) and require the provision of automated operational support mechanisms as a part of the provisioning of each unbundled element.

The FCC also should adopt the TCC's proposed core list of unbundled network elements that all ILECs must immediately provide. This list then can be expanded based on requests for additional network elements in the future.

5. Congress provided another important option for local entry: resale of ILEC retail services. The FCC must adopt a rule specifying that all retail ILEC services must be made available for resale at wholesale rates. The FCC should establish a methodology for calculating wholesale rates that excludes all retail-related costs, and should specify the USOA accounts that contain such costs. The FCC also should make clear that resale of retail services is a distinct option from purchase of unbundled network elements in a platform configuration, both of which are available to requesting carriers under the Act.

6. Section 251(b)(5) and (c)(3) require ILECs to price interexchange access at cost-based rates as provided by Section 252(d)(1). Access is indistinguishable from use of the ILEC network as interconnection under Section

251(c)(2) or as unbundled network elements under Section 251(c)(3). The mandate to price access at economic cost -- which is the LECs' own input cost -- also is critical as a prerequisite to grant of any RBOC applications to provide in-region interLATA service.

7. The Commission must interpret Section 251(f) strictly so as to maximize the benefits of competition for consumers in rural as well as urban and suburban areas. ILECs should be excused from the requirements of Section 251 only in limited circumstances and for limited periods.

8. The FCC must require ILECs to install automated, nondiscriminatory operational support mechanisms in connection with their provision of both unbundled network elements and retail services for resale. The FCC-prescribed standards should include a requirement that all processes be performed seamlessly so that the competitor's customer is unable to perceive an ILEC-related difference between the service provided by the ILEC and that provided by the competitor.

9. The FCC must continue to have a strong role in implementing and enforcing the Act. It will do so directly, through its Section 252(e)(6) and Section 271(c)(2) responsibilities, and indirectly through the Section 208 complaint process and through primary jurisdiction referrals from reviewing courts.

In sum, the FCC must take a strong leadership role in establishing and enforcing uniform pro-competitive national rules to implement Sections 251 and 252 of the Act.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of the Local	)	CC Docket No. 96-98
Competition Provisions in the	)	
Telecommunications Act of 1996	)	

COMMENTS OF THE TELECOMMUNICATIONS CARRIERS FOR COMPETITION

The Telecommunications Carriers for Competition ("TCC") hereby submits its comments in response to the Commission's Notice of Proposed Rulemaking ("Notice"), FCC 96-182, released in the above-captioned proceeding on April 19, 1996.

INTRODUCTION

The Telecommunications Carriers for Competition is a coalition of some of the nation's leading telecommunications service providers. The TCC was organized to address critical issues affecting the development of local exchange competition in this country. Its members include AT&T; the Competitive Telecommunications Association ("CompTel") and its approximately 175 members; General Communication, Inc.; LCI International Telecom Corporation; LDDS WorldCom; and MCI Telecommunications Corporation.

This group represents a cross-section of the long distance industry, from the largest to the smallest carriers. Despite the great differences in the makeup of these companies, we share a common view of what is required to open the local exchange to competition. In particular, the TCC is concerned that the Telecommunications Act of 1996 (the "1996 Act" or the "Act") be implemented in accordance with its pro-competitive terms. We fully agree with the Commission that its rules implementing Section 251 should "serve as the cornerstone of the pro-competitive provisions of the statute." Notice, ¶ 24. These comments are directed to that end.

The purpose of these joint comments is threefold. First, we set forth a common vision of steps that must be taken to ensure a competitive telecommunications market in the future. Second, we present a unified view of specific requirements of Sections 251 and 252 of the Telecommunications Act of 1996. Third, we offer a joint description and analysis of some of the more technical issues addressed in this docket: costing and pricing, the definition of unbundled network elements, and automated operational support systems.

These joint comments are fully supported by each of the members of the TCC. The individual TCC members also will file their own comments in this proceeding. There they will address additional issues, as well as present an amplified view on many of the matters discussed in this joint filing. The members also may have differing views on certain issues. We expect that the individual members' comments will be helpful in offering the FCC a range of approaches from which to craft a single set of rules -- and in implementing, enforcing, and expanding upon those rules thereafter.

I. COMPETITORS WILL DEPEND ON THE INCUMBENT LEC NETWORK TO PROVIDE COMPETING LOCAL SERVICE FOR THE INDEFINITE FUTURE.

[Notice, Sections I.B. and II.A.]

The Commission's decisions in this docket will determine whether consumers ever receive the competitive choices promised by the 1996 Act. That Act establishes a goal of broad competition by many carriers across the full range of telecommunications services. It sets the stage for the collapse of lines between local and long distance markets, and the rise of full-service competition on a one-stop shopping basis.

The TCC members fully embrace the goals of the Act. We look forward to the opportunity to offer consumers new services at lower prices. We stand ready to unleash the full power of competition.

But the danger of this new industry structure comes from the fact that it will substantially *increase* our dependence on the ILEC local exchange network. For example, as the FCC noted in the Notice, AT&T estimates "that it would have to invest approximately $29 billion to construct new facilities in local markets in order to provide full facilities to reach 20 percent of the 117 million access lines served by the BOCs." 1/ These estimates dramatize how long distance carriers will be dependent upon the ILECs. AT&T is unable to replicate the ILEC network on any basis that would permit it to compete to provide local service to its existing customer base. And these problems are magnified for other companies that lack AT&T's resources. The LECs nationwide provide over 147 million local loops, 2/ over 17,000 end offices, 3/ and about 2.5 billion kilometers of cable and wire facilities. 4/ They also own the data bases, operational support systems and other

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1/ Notice, ¶ 7 n.15.

2/ See Statistics of Communications Common Carriers (FCC 1993/1994), Table 2.5, pp 20-21 (Total Switched and Special Access Lines for Reporting Local Exchange Companies as of Dec. 31, 1993).

3/ See Infrastructure of the Local Operating Companies Aggregated to the Holding Company Level. Industry Analysis Division, Common Carrier Bureau, FCC (April 1995).

4/ See Statistics of Communications Common Carriers, supra, Table 2.6, p. 22.

facilities that are necessary to provide local service. All of this took over 100 years to deploy. This infrastructure is the very foundation of ILEC market power.

It is important to contrast these entry barriers with the absence of barriers to the provision of interLATA service by the RBOCs. The only obstacle is the legal restriction in the 1996 Act. RBOCs already provide both local and toll retail services, and therefore already have all the operational, marketing and customer support systems they require. The RBOCs already switch virtually every interLATA call in their capacity as access vendor. They do not need to install any additional switching capacity; they simply need to redirect interLATA traffic to their own networks. The RBOCs already have extensive excess capacity in their in-region fiber networks that they can use to transport the large percentage of interLATA traffic that never leaves their regions. Last, but not least, to the extent that they require out-of-region facilities, they can obtain and have even announced contracts for those facilities on a competitive basis from among several competing national and numerous regional networks. It is no wonder that the Chairman of Bell Atlantic recently observed that long distance is a market that "you can enter with almost no investment." 5/

The 1996 Act fully recognizes this imbalance. Congress understood that the ubiquitous ILEC wireline network and its constituent parts cannot effectively be duplicated, at least not for the foreseeable future. The Act therefore requires ILECs to make that network available to other carriers at cost and on nondiscriminatory terms.

This is hardly a new concept. The Commission is very familiar with the fact that IXCs have had to depend upon access to the ILEC local network to originate and terminate virtually all of their interexchange traffic. The

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5/ Business Week, May 6, 1996, at 32.

Modification of Final Judgment and the Commission's access rules attempted to create an environment in which interLATA long distance competition was not harmed by ILEC discrimination in favor of themselves. Of course, the main safeguard against such discrimination has been the line of business restrictions on the RBOCs. Those restrictions arose from a conclusion that existing regulatory rules and related enforcement were not sufficient to prevent discrimination.

The 1996 Act marks a complete change in direction. In the full-service market to come, carriers will be forced to use the ILEC network as inputs for both interexchange and local services. Clearly, discrimination by the ILECs in favor of their own local services would prevent others from offering consumers new local choices.

Second, the Act puts existing interexchange competition at jeopardy through ILEC discrimination. It does so in part by setting the stage for the RBOCs to offer interLATA services. But the danger to competition also comes from evaporation of lines between telecommunications products. In a full service market ILECs would be able to leverage their market power in the local service arena to weaken competition in toll services as well. Potentially only the ILEC would be in a position to offer efficient full service packages to consumers. The result could be to undo over a decade of progress to create a fully competitive interexchange market.

But third, the Act increases the regulatory responsibility of the Commission and the states to prevent this outcome. The Act assumes that the Commission can create (and enforce) an entirely new set of regulations that will be sufficient to prevent ILEC discrimination and empower full service competition by other carriers. The Act does not shy away from the overwhelming dependence of other carriers on access to the ILEC network and its component parts. But the Act charges the Commission to take all necessary actions to create rules that will deter and ultimately prevent ILEC discrimination. The Act charges the states in the first instance with implementing those national rules developed by the FCC. And the Act creates new, supplemental, enforcement and appeal procedures through which ILEC non-compliance can be addressed.

Again, the TCC members welcome the potential to expand their service offerings for customers. But our ability to do so will turn directly on whether this docket establishes an adequate foundation for cost-based, nondiscriminatory use of the ILEC network for any and all of the services that we may provide. TCC believes that neither the magnitude nor the importance of this proceeding can be overestimated.

ILECs have absolutely no market incentive to cooperate in this process. Quite the contrary, the ILECs have every incentive to block practical entry opportunities for their potential rivals at every turn. Their incentive is to maintain as much of their market power as possible, not seek the fullest level of local competition. They will offer the Commission the minimum possible in this docket. And once rules are adopted, they inevitably will claim Section 271 compliance, will interpret the rules narrowly, stonewall at every possible turn. In contrast, other carriers will indefinitely depend on use of the ILEC network and its components.

Sections 251 and 252 were written because Congress fully recognized these practical problems. Congress could have decided that ILEC discrimination was so intractable that local and full-service competition was impossible. Instead, Congress tasked this Commission and the states with the job of preventing such discrimination. As discussed further in the next section, this assignment is very difficult given that ILECs face no market incentives to cooperate. It follows that the Commission can begin to meet its responsibility only by adopting detailed rules now that can be enforced in the future to produce the competitive local service market that Congress envisioned.

II. CORE NATIONAL STANDARDS ARE ESSENTIAL TO PROMOTE COMPETITION

[Notice, Sections I.B., II.A., II.B.1., ¶¶ 14-48]

A. Unequal Bargaining Power Makes Voluntary Negotiation Difficult in the Absence of Federal Standards.

The Act relies initially on private consensual bargaining to achieve local entry and competition. In theory, reliance on a voluntary negotiation process could provide for the most rapid entry of new entrants into the local marketplace. Under conditions where ILECs and other carriers have relatively equal bargaining power, negotiations would be the clear preference.

However, under the current situation, where the ILECs have all of the bargaining power and little incentive to negotiate, negotiations are unlikely to produce agreements that promote effective, sustainable local competition. Other carriers must negotiate with the ILECs because they rely on access to the ILEC networks -- whether for interconnection, unbundled network elements, or resale -- in order to offer their customers ubiquitous services. Those carriers have no alternatives; they cannot threaten to take their business elsewhere.

The ILECs, on the other hand, require nothing from other carriers. 6/ Moreover, because the ILECs do not want the advent of competition to erode their monopoly position, they have every incentive to frustrate the aims of new entrants. The fact that the ILECs have all of the bargaining power, and have no incentive to negotiate, is likely to lead to prolonged, unproductive "negotiations" between ILECs and carriers who require the use of their networks. As we show below, experience to date suggests that this is likely to be the case.

6/ Their only incentive is to win premature deregulatory concessions and approval from the regulators.

Strong, uniform national rules promulgated by the Commission, however, can help equalize the bargaining power of the ILECs vis a vis their potential rivals. They can also ensure that competing carriers are taken seriously by the ILECs, by providing recourse against ILEC anticompetitive behavior. National rules also can speed the arbitration process (and with it the arrival of local competition), allowing the parties and state regulators to focus on technical, operations and implementation issues that inevitably arise.

Finally, uniform national rules will mean that competing carriers will not have to fight the same battles in fifty states and with even more numerous ILECs. Instead, they can focus their resources on investment and service development. Uniform national rules also will assist in design and deployment of services and network facilities because they can be tailored to the uniform availability of a baseline set of unbundled elements and service resale options.

In sum, without such national rules, the prospect of a competitive local market is seriously threatened. We strongly endorse the FCC's tentative conclusion to adopt such rules, while encouraging the FCC to leave room for State commissions and private parties to expand upon the core national requirements, consistent with the Act and the FCC's rules.

B. The Experiences of TCC's Members Demonstrate the Practical Limitations of Voluntary Negotiations.

The member companies of TCC have found the negotiating process with the ILECs to be time-consuming and unproductive. 7/ We describe in this

7/ See, e.g., AT&T Statement of Status of Negotiations with Bell Atlantic-Maryland, May 6, 1996, Maryland Case No. 8721. A copy of the status report is attached as Appendix A.

section some of the difficulties that TCC members have encountered. 8/ We do not mean to suggest that every ILEC has engaged in each form of such conduct. The point is, rather, that strong national guidelines are required to prevent this behavior by those ILECs that do engage in delaying tactics.

One approach that some incumbent LECs have taken is to require new entrants to sign very restrictive non-disclosure agreements before they are willing to enter into genuine negotiations. 9/ This puts the ILEC in a position of power in this unique set of one-to-multiple company negotiations because only the ILEC knows the positions they have taken with each company and the responses of those companies. Many ILECs also have refused to provide copies of the cost studies that underlie the pricing they propose. This has made it impossible in the negotiations to reach cost-based prices for unbundled network elements or interconnection. Additionally, some ILECs have refused to make key executives available as an initial step to discuss the scope and key elements of the negotiation. Instead, ILEC representatives often have had only narrow expertise and limited authority to negotiate, further slowing the negotiation process

Some ILECs also have refused to provide copies of agreements with other telecommunications carriers or to file these agreements with State commissions. Even though the language of Section 252(a)(1) of the Act is clear 10/,

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8/ We do not offer specific examples for each of these difficulties because the existence of ILEC demanded nondisclosure agreements may prevent TCC members from disclosing these problems.

9/ See, e.g., Association for Local Telecommunications Services (ALTS) Handbook, *"Implementing Local Competition Under the Telecommunications Act of 1996,"* April 8, 1996, (version 1.1), at 10 and Attachment B.

10/ "The agreement, including any interconnection agreement negotiated before the date of enactment of the Telecommunications Act of 1996, shall be submitted to the State commission under subsection (e) of this section." 47 U.S.C. 252(a)(1).

the ILECs have taken the position that prior agreements with independent telcos are not covered by the requirement for filing in the Act, and that only agreements signed following the enactment of the bill with new entrants under Sections 251 and 252 will be filed with the state commissions. 11/ **[¶ 48]**

It is imperative that all agreements are filed on the public record to ensure that all carriers receive non-discriminatory treatment, that network elements are fully unbundled, that interconnection is permitted at any technically feasible point, and that these agreements are consistent with the 1996 Act. **[¶ 48]**

TCC members point out that because of the unfair bargaining power of the ILECs, in some negotiations and in filings in state commission proceedings some ILECs have attempted to limit the services that will be available for resale despite the plain requirements of the Act. 12/ Some ILECs also have made

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11/ Several State commissions already have required the filing of all agreements, including agreements between incumbent LECs. The Colorado Commission has adopted emergency rules requiring the filing of all existing interconnection agreements. Emergency Rules Relating to the Approval of Interconnection Agreements Negotiated By Telecommunications Providers, Decision Adopting Emergency Rules, Docket No. 96R-142T, Decision No. C96-358, April 10, 1996. The Arkansas Commission also recently ordered the filing of all agreements negotiated between Southwestern Bell or GTE and other carriers, including other Arkansas local exchange carriers, by April 19, 1996. In the Matter of Negotiated Interconnection Agreements, Docket No. 96-098-U, Order No. 1, Arkansas Public Service Commission, April 1, 1996. See also Local Exchange and Exchange Access Telecommunications Competition, North Carolina Utilities Commission Docket No. P-100, SUB 133, Order Requiring Disclosure, April 23, 1996 (requiring public disclosure of pre-Act interconnection agreement filed with Commission between GTE South, Inc. and Mobile Communications Service Corp. of the Southeast).

12/ Existing state laws also can serve as a barrier to exercise of rights under the 1996 Act, to the extent ILECs point to them as a reason not to negotiate. For example, the Texas legislature mandated a 5 percent discount be applied to retail rates. The Florida legislature has imposed restrictions on resale pricing if the underlying service is offered below cost (see Ch. 364 Florida Statutes, Section 163(2)). These state law requirements are preempted where inconsistent with the Federal Act, of course, but ILECs nevertheless have relied on them in the meantime.

demands on the other carriers that would place these potential rivals at a competitive disadvantage vis a vis the ILEC. We have attached as Appendix B a specific example from a US West negotiation with MCI to demonstrate the delays and difficulties associated with the voluntary negotiation process. Attempts by state commissions to get parties to negotiate differences prior to passage of the Act also have met with little success. 13/ Finally, ILECs have employed other tactics to delay competition, and doubtless will continue to do so. We have set forth a few examples of such tactics in Appendix C.

The point here is that many threshold local competition issues must be resolved by the FCC, rather than being left to the negotiation process. The Commission must adopt clear, strong and detailed national rules to fully implement the requirements of Sections 251 and 252.

C. The FCC and State Commissions Have Important Roles in Implementing the Act.

In Section 251(d)(1), Congress expressly directed the Commission to act -- and to act expeditiously -- to create a stable legal and regulatory framework for the new telecommunications market place. Congress contemplated that the Commission would adopt a core set of national standards governing interconnection, unbundling, and pricing.

13/ In Massachusetts, the Hearing Examiners ordered the parties to attempt to settle as many issues as possible in a comprehensive local competition proceeding involving interconnection, unbundling, resale, and other issues. After nearly two months of settlement discussions, during which time the proceedings were suspended, the parties reported back that they were unable to reach settlement of any of the issues in the case, and the case resumed. See Hearing Officers' Notice, D.P.U. 94-185, October 23, 1995 (requesting "that the parties enter into serious settlement discussions"); Notice of Suggested Briefing Questions, D.P.U. 94-185, January 16, 1995 (setting scope of briefing in resumed proceeding).

In promulgating rules, the Commission should look to the stated needs of potential local service providers. It also should look to the state local competition rules that have been adopted to promote competition. The FCC also should recognize, however, that with respect to many of the requirements of Section 251 and 252 of the Act, few if any state commissions have developed policies or rules that could serve as a model for the FCC. 14/ As a practical matter, even those few states considering local competition have had to reexamine their actions in light of the new Act.

Once the Commission has adopted specific requirements (regarding interconnection, unbundling, service resale, and pricing), state regulators should have discretion to supplement them as part of the Act's implementation process. For example, it should be the responsibility of the Commission to adopt policies that require ILECs to unbundle network elements required by competing carriers. It should be the role of the state regulators to determine whether this list of core unbundled elements has been successfully put in place and if additional elements requested during negotiations are technically feasible and priced correctly.

Similarly, the Commission should require that prices for these unbundled network elements be based on total service long run incremental cost ("TSLRIC"). The Commission should also apply this methodology to those Section 251 unbundled elements and interconnection.

For example, under Section 252(e)(5), the FCC must set rates in any case in which a state fails to act. As another example, to ensure that local competition can develop quickly and that delaying tactics by the ILECs will not succeed, the FCC could include in its Section 251(d)(1) regulations specific rate

14/ Unbundled local switching is an example of one network element that has not been examined closely by many states. See discussion in Section IV, below.

benchmarks with density zones on a state-by-state basis based on the current Hatfield analysis. 15/ Parties would be free to negotiate different rates (subject to the standard in Section 252(e)(2)(A)), and State commissions could establish different rates. The FCC's regulations would provide that rates lower than the benchmark rates are presumptively consistent with the standard in Section 252(d)(1) and that higher rates must be shown to comply with the TSLRIC standard. This approach establishes a consistent national benchmark and facilitates judicial review of rates established by State commissions to ensure that they are consistent with the statute and with the methodology established by the FCC.

The basic legal and regulatory framework needs to be set, moreover, before the state commissions arbitrate agreements and federal courts review those arbitrations. Lack of specificity now will exact a heavy toll later, for the Commission and the federal courts will be forced to resolve on an ad hoc basis a host of issues involving the proper interpretation and application of Sections 251 and 252. The resulting instability would impede the emergence of real competition in the local market, deter efficient investment, and deprive consumers of competitive choices.

III. INTERCONNECTION AND UNBUNDLED NETWORK ELEMENTS MUST BE PRICED AT ECONOMIC COST (TSLRIC).

[Notice, Section II.B.2.d.1.-d.3., ¶¶ 117-148].

The pricing of interconnection and unbundled network elements will determine whether, how, and how rapidly local competition develops. Pricing will also have a critical impact on long distance competition as the Bell Operating

15/ See discussion of Hatfield study, Section III.C., below.

Companies ("BOCs") vertically integrate into the interLATA business. The 1996 Act requires pricing of interconnection and unbundled network elements to be "based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or unbundled network element." 47 U.S.C. § 252(d)(1)(A)(i)

In the TCC's view, cost in the context of the legislation must mean economic cost. Congress specifically ruled out the use of "rate-of-return or other rate-based proceeding[s]" in establishing cost. 47 U.S.C. § 252(d)(1); Notice, ¶ 123. The Commission's tentative conclusion that ". . . this language precludes states from setting rates by use of traditional cost-of-service regulation, with its detailed examination of historical carrier costs and rate bases," is absolutely correct. Id. **[¶ 123.]**

The Commission also has correctly concluded that the proper economic cost standard is Long Run Incremental Cost ("LRIC"). Notice, ¶ 126. The particular form of LRIC appropriate for setting interconnection and unbundled network elements is Total Service Long Run Incremental Costs (TSLRIC). We discuss one model for measuring TSLRIC in Section III.C. below, the Hatfield model. [Notice, ¶¶ 126-27]

The remainder of this section addresses specific pricing and costing issues raised by the Commission. (At the end of this section, we provide a glossary of terms, as requested by the Commission.)

A. Cost Concepts

The Commission has asked commenting parties to provide definitions of various cost concepts, including Long Run Incremental Cost, Total Service Long Run Incremental Cost, forward-looking costs, joint costs, common costs, shared costs, and stand-alone costs. **Notice, ¶ 126**. We provide a glossary of definitions of these terms in Section 3.E, below. These concepts are <u>also</u> discussed below. The three key concepts for this pricing debate are historical costs, forward-looking costs and shared costs. For purposes of pricing individual services, the concepts of attributable and non-attributable costs are also important. **[¶ 126]**

1. Historical Costs

Historical costs are simply the result of actual transactions that have been entered on a company's books. For example, the cost of a piece of equipment purchased in 1990 will be recorded in the accounting ledgers. That cost, less any accrued depreciation, is part of the embedded or historical cost of the firm. These costs are closely related to embedded costs, which are the current costs of providing service using existing network architecture and equipment. Under rate of return regulation, this historical cost is used in setting rates. As noted above, current rates are based on these historical costs. This is true even in most price cap systems. Initial price caps have typically ignored economic cost and relied on rates in place -- i.e., rates reflecting historical costs 16/

Allowing ILECs to recover embedded costs in the rates they charge competitors for interconnection and unbundled network elements will harm consumers and competition in several ways. First competition is valued not for the sake of competition or the welfare of competitors, but because it promotes static and dynamic economic efficiency. If competitors have to pay inefficiently high

16/ The Commission's LEC price cap plan has been in effect for only a few years. The initial price cap rates were based on the embedded revenue requirement. The productivity factors used by the Commission to adjust rates have been consistently low and many carriers have enjoyed excessive earnings as a result. Consequently, current rates do not reflect economic cost. Moreover, existing access rates are based on artificial cost allocations as a result of the separations rules and other arbitrary state and federal accounting procedures.

interconnection and unbundled network element charges, the rates that consumers pay will be inefficiently high. **[¶ 144]**

Second, excessive rates will discourage entry and investment in local markets. This is because high input costs will force higher output prices, and thereby reduce consumer demand. Market size will be restricted and opportunities for investment correspondingly reduced.

Third, if ILECs are allowed to recover embedded costs in rates for interconnection and unbundled network elements, they will have degrees of freedom to engage in anticompetitive, strategic or discriminatory pricing by manipulating the costs of individual rate elements. Both local and long distance markets could be adversely affected. That is why pricing interconnection and unbundled network elements, including carrier access, at economic cost is a statutory prerequisite for BOC interLATA entry.

Historical costs have been used by regulators to set prices under rate of return regulation for several reasons. First, historical costs have been more readily observable than forward looking costs. In recent years reliable third party economic cost models for local telephone service been made available for use by regulators in setting rates at economic cost. Prior to the availability of these models, the regulated monopoly controlled cost information and cost models. Second, regulators have generally not devoted resources to oversight of ILEC spending. Third, in a monopoly environment, prices based on historical cost -- indeed, prices based without any relation to costs -- were sustainable.

None of the justifications for basing rates on historical cost exists today. The Hatfield Model described below shows that reliable TSLRIC studies can be performed by regulators. The 1996 Act specifically rejects the use of historical cost approaches to setting rates. Finally, opening all telecommunications markets